No. 15,105

In the

United States Court of Appeals

For the Ninth Circuit

PALO ALTO MUTUAL SAVINGS AND LOAN ASSOCIATION,

Appellant,

vs.

RALPH E. WILLIAMS, Trustee of the Estate of John E. Duskin, Jr., General Contractor, Bankrupt,

Appellee.

Brief of the State of California Amicus Curiae in Support of Appellants

Appeal from the United States District Court
for the Northern District of California, Southern Division

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I.

NATURE OF THE STATE'S INTEREST

This amicus curiae brief has been filed by the State of California, sponsored by Edmund G. Brown, Attorney General of that State, pursuant to the Rules of the United States Court of Appeals for the Ninth Circuit (Rule 18, Subdiv. 9(c)). The State of California files this brief in support of the contentions of appellant that:

1. In bankruptcy proceedings secured creditors should be paid interest to the date of payment of their

secured debt if the security is adequate and the debt so provides.

2. *Beecher v. Leavenworth State Bank*, 192 F.2d 10 (9th Cir., 1951), was incorrectly decided and is contrary to holdings of the United States Supreme Court and of the Courts of Appeal in other circuits, and to the language of the Bankruptcy Act and the spirit and logic of bankruptcy proceedings.

The rule of the *Beecher* case is that unless the assets of a bankrupt's estate are sufficient to pay the principal and pre-bankruptcy interest of all claims (secured and unsecured) in full, no post-bankruptcy interest will be paid to a secured creditor even if his security is sufficient. This rule has been applied to all secured creditors. The State is vitally interested in the present proceeding since it frequently has tax liens on property of persons who become bankrupts. The rule of the *Beecher* case has been applied to deny the State post-bankruptcy interest on its liens.

While we subscribe fully to the contentions of appellant, it is our belief that neither the appellant nor the appellee has cited the line of cases which most clearly and adequately sets forth the viewpoint of the United States Supreme Court on the issues here presented. The best statement is found in *Ticonic Bank v. Sprague*, 303 U.S. 406, 413:

> "*This court has already held that a lienholder may look to his lien not only for the principal but also for interest accruing up to the date of payment, though his debtor has gone into bankruptcy.*" (Emphasis added.)

The rule stated in the *Ticonic* case has been cited with approval and followed in many other United States Supreme Court cases. Including among the approving cases is *Vanston Bondholder's Protective Committee v. Green* (1946), 329 U.S. 156, 164. The *Vanston* case was relied on by the

Beecher case to reach a result contrary to the rules set forth in the *Vanston* and *Ticonic* cases.

For the reasons stated below we respectfully request this Court to review its decision in the *Beecher* case and adopt the general rule that secured creditors in bankruptcy are entitled to interest to the date of payment where the security is adequate.

II.

ARGUMENT

A. Introduction.

The *Beecher* case, *supra*, resulted in a radical and surprising change in bankruptcy proceedings in the Ninth Circuit by establishing a rule that is contrary to nearly every reported case or other authority in bankruptcy.

B. As a General Rule the holder of a Valid Lien on Property of a Bankrupt May Assert the Lien Against the Property to the Same Extent as if the Bankruptcy Had Not Intervened.

As a rule of thumb, it has always been clear that, as far as possible, liens on property are not to be disturbed by bankruptcy proceedings. In fact, the general rule is that the holder of a valid lien on property of a bankrupt may assert the lien against the property to the same extent as if bankruptcy had not intervened (*Goggin v. California Labor Div.*, 336 U.S. 118, 93 L.Ed. 543; *Yeatman v. New Orleans Sav. Inst.*, 95 U.S. 764, 767, 24 L.Ed. 589; 6 Am. Jur., pp. 1116-1117, Bankruptcy, § 949; Annotation, 75 L.Ed. 647.) It is, and has been, the general purpose of Congress to safeguard liens perfected before the bankruptcy (*Goggin v. Calif. Labor Div.* (1948), 336 U.S. 118, 126-127; *Hiscock v. Varick Bank*, 206 U.S. 28; *In re Knox-Powell-Stockton Co.* (9th Cir., 1939), 100 F.2d 979, 982, and authorities cited therein). In our research and experience, the *Beecher* rule as applied in this Circuit is the only example where the federal

courts have permitted the referees to reduce the amount due to a secured creditor where the security is adequate to pay the creditor in full.*

C. The Bankruptcy Act Treats Secured Claims in a Different Manner From Unsecured Claims.

At the outset, the difference between secured claims and secured creditors on one hand and unsecured claims and unsecured creditors on the other, must be clearly defined. By reason of the Bankruptcy Act, secured claimants who hold valid liens on property have been treated differently from unsecured claimants. The design of Congress is to protect all liens and lienholders except those liens which are void or voidable under the Bankruptcy Act (*In re Knox-Powell-Stockton Co.* (9th Cir., 1939), 100 F.2d 982 and authorities cited therein). The Bankruptcy Act does not vest in the trustee any greater rights in the property than belong to the bankrupt at the time when the trustee's title accrues (*Security Mtge. Co. v. Powers* (1928), 278 U.S. 149). The liens of secured creditors must remain undisturbed.

The broad purpose of bankruptcy is to marshal the bankrupt's assets for distribution to unsecured creditors. It is considered that secured creditors need not participate in bankruptcy proceedings, since they can look to their security. The Bankruptcy Act was formulated with the secured creditor precluded from participation in most of the bankruptcy proceedings. Briefly, we will illustrate some of the distinctions between the treatment of secured and unsecured creditors:

1. Under section 59b of the Bankruptcy Act (11 U.S.C. § 95), three or more creditors must join in the

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*Of course, in all cases where security is sold in bankruptcy the costs of the sale are first deducted from the proceeds before payment of secured creditors.

petition for bankruptcy unless all the creditors of the bankrupt are less than twelve in number, in which case a single creditor may file a petition. The required number of petitioning creditors is jurisdictional. In computing the required number of creditors, those who have security or priority may not be counted unless their claims exceed the value of their securities or priorities.

2. With regard to the right to vote at creditors' meetings, only unsecured creditors of the bankrupt are entitled to vote. Under section 56 of the Bankruptcy Act (11 U.S.C., § 92), creditors holding claims which are secured, insofar as their right to vote depends on such claims, have no vote or voice at the creditors' meetings. Only if the secured creditor surrenders his security or by reason of the fact that his claim exceeds the value of his security and only for such excess is he allowed to vote.

3. Expenses of bankruptcy administration are solely chargeable against the general assets of the estate available for general creditors. The collateral of a secured creditor is chargeable only to the extent that the security is directly benefited thereby. (*In re Rice Leghorn Farm* [1953], 113 Fed. Supp. 903; *In re Dannielle* [1953], 117 Fed. Supp. 178).

4. The requirements of time and requirements of proof of secured claims are entirely different from unsecured claims. The alternative courses available to secured creditors are well set forth in *United States v. Chase Bank* (1947), 331 U.S. 28, 33:

> "Under these provisions [of the Bankruptcy Act], there are several avenues of action open to a secured creditor of a bankrupt. See 3 Collier on Bankruptcy (14th ed.) pp. 149-157, 255-259. (1) He may disregard

the bankruptcy proceeding, decline to file a claim and rely solely upon his security if that security is properly and solely in his possession. *In re Cherokee Public Service Co.*, 94 F.2d 536; *Ward v. First Nat. Bank*, 202 F. 609. (2) He must file a secured claim, however, if the security is within the jurisdiction of the bankruptcy court and if he wishes to retain his secured status, in as much as that court has exclusive jurisdiction over the liquidation of the security. *Isaacs v. Hobbs Tie & Timber Co.*, 282 U.S. 734. (3) He may surrender or waive his security and prove his entire claim as an unsecured one. *In re Medina Quarry Co.* 179 F. 929; *Morrison v. Rieman*, 249 F. 97. (4) He may avail himself of his security and share in the general assets as to the unsecured balance. *Merrill v. National Bank of Jacksonville*, 173 U.S. 131; *Ex parte City Bank*, 3 How. 292, 315."

5. All unsecured creditors with provable claims who had notice of the proceedings may be discharged in bankruptcy. Secured claims may not be affected by a discharge in regular bankruptcy proceedings but survive the debtor's discharge as to the amount of the security.

D. Post-Bankruptcy Interest on Secured Claims Should Be Paid to the Date of Payment to the Extent of the Security if the Statute or Security Debt so Provides.

1. THE UNITED STATES SUPREME COURT HAS UNEQUIVOCALLY RULED THAT SECURED CREDITORS SHOULD BE PAID INTEREST TO DATE OF PAYMENT.

The United States Supreme Court has clearly and unequivocally stated its position on the issue here involved. In *Ticonic National Bank v. Sprague* (1938), 303 U.S. 406, 413, the United States Supreme Court held that a secured creditor, who has a lien on assets which are sufficient to pay the principal and interest of the lien, is entitled to interest to

the date of payment of his debt, even though the total assets of the insolvent party are not sufficient to pay in full all creditors' claims.

Ticonic National Bank v. Sprague, 303 U.S. 406, 413 concerned an insolvent bank in receivership. The court approved the payment to secured claimants of interest which accrued during the administration of the receivership. The court also stated (p. 413):

> *"With respect to analogous liquidations the rule just announced has been long in force. This Court has already held that a lienholder may look to his lien not only for the principal but also for interest accruing up to the date of payment, though his debtor has gone into bankruptcy* (Coder v. Arts, 213 U.S. 223, 245, *affirming* 152 Fed. 943, 950) * * *". (Emphasis added.)

We respectfully submit that the *Ticonic* case is determinative of the issue here involved. It is significant to note that the *Ticonic* case was neither cited nor discussed in the *Beecher* case. The *Ticonic* case and the principle there involved have been cited and approved by the United States Supreme Court in a number of bankruptcy cases. See for example *Vanston Bondholder's Protective Committee v. Green* (1946), 329 U.S. 156, 164; *Reconstruction Finance Corp. v. Denver & Rio G. W. R. Co.* (1946), 328 U.S. 495, 521, ftnt. 25; *Group of Investors v. Milwaukee R. Co.* (1943), 318 U.S. 523, 573; *Ecker v. Western Pac. R. R.* (1943), 318 U.S. 448, 510.

In the *Reconstruction Finance* case, supra, the court stated at page 521 in footnote 25 concerning a corporate reorganization in bankruptcy:

> "Interest accrues on the secured claims until the effective date of the plan."*

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> "Interest accrues on the secured claims until the effective date of the plan."*

*The effective date of a plan is of necessity long after the petition in bankruptcy is filed.

The *Vanston* case is particularly noteworthy since it is the case relied upon in the *Beecher* decision. It is respectfully submitted that the court in the *Beecher* case misinterpreted the *Vanston* case since this court in the *Beecher* case while relying on the *Vanston* case failed to note the following quotation:

> "Simple interest on secured claims accruing after the petition was filed was denied *unless the security was worth more than the sum of principal and interest due.*" (Emphasis added.) (*Vanston etc. v. Green* (1946), 329 U.S. 156, 164)

None of the cases cited immediately above, except the Vanston case, has been cited by the appellant or appellee in the present case. Not only should these cases be considered by the court, but we respectfully submit that these cases are controlling as to the present issues.

Another United States Supreme Court decision unmentioned by either appellant or appellee presents an analogous problem. In *Security Mtge. Co. v. Powers* (1928), 278 U.S. 149, attorney's fees were provided for in the basic obligation. The court held that attorney's fees were held to be part of the mortgage debt, and allowed the fees to be collected out of the security, even though the fees accrued after adjudication of bankruptcy.

In addition, the Supreme Court of the United States, in *Sexton v. Dreyfus* (1911), 219 U.S. 339, stated:

> "The view that *we adopt* is well presented in the late Judge Lowell's work on Bankruptcy, section 419; seems to have been entertained in *Coder v. Arts,* 8th Cir., 152 Fed. 943, 950 * * *" (Emphasis added.)

The view presented in section 419 of Judge Lowell's work which the Supreme Court of the United States adopted is that interest on secured claims is payable to the date that

the principal is paid if the security is sufficient to pay both principal and interest, even if the assets of the bankrupt are not sufficient to pay other unsecured creditors in full. The general creditors cannot object since the security belongs, not to the bankrupt, but to the secured creditor (See an excellent discussion of this problem in *In re Tele-Tone Radio Corp., etc.* (D.C. N.Y., 1955), 133 F. Supp. 739, 751). The opening sentence of section 419 of Judge Lowell's work states:

> "If the security exceeds the debt, the creditor receives interest until the settlement with the assignees [the bankruptcy trustee] whether by redemption, sale or otherwise."

Furthermore, *Coder v. Arts*, 152 Fed. 950, as cited by the Court in the *Sexton* case, states:

> "But the proceeds of these mortgaged lands appear to be ample to pay the principal and interest of the debt to the mortgagee, Arts, and where a trustee sells mortgaged property of the Bankrupt's estate free of the mortgage, and the proceeds of the sale are sufficient for that purpose, the mortgagee is entitled to payment of the interest upon his mortgage debt as well as to the principal, out of the proceeds, in accordance with the terms of the note and mortgage."

The United States Supreme Court, in affirming the lower court in *Coder v. Arts* (1909), 213 U.S. 223, 245, unequivocally approved the payment of interest to the date on which the principal was paid. The Court stated:

> "Nor do we think the circuit court of appeals erred in holding that, inasmuch as the estate was ample for that purpose, Arts was entitled to interest on his mortgage debt."

See also, *Louisville Joint Stock Land Bank v. Radford* (1935), 295 U.S. 555; *American Iron Co. v. Seaboard Air*

Line (1914), 233 U.S. 261; *U. S. v. Paddock* (5th Cir., 1951), 187 F.2d 271; *Oppenheimer v. Oldham* (5th Cir., 1949), 178 F.2d 386; *Wilson v. Dewey* (8th Cir., 1943), 133 F.2d 962, 965.

The only support for appellee's contentions is dicta found in a footnote at page 330 in *City of New York v. Saper* (1949), 336 U.S. 328. The *Saper* case was not concerned with secured claims but with unsecured claims. The footnote relied upon by the appellees concerns the purported English practice. (See the apparent confusion in English bankruptcy law on secured claims discussed in *Merrill v. National Bank of Jacksonville* (1898), 173 U.S. 131, 174; Hanson, Secured Creditor of Insolvent, 34 Mich. L. Rev. 309, 324-328 (1936).) The implication in this footnote in the *Saper* case is clearly contrary to the rule laid down by the United States Supreme Court in the many cases discussed above.

2. POST-BANKRUPTCY INTEREST ON SECURED CLAIMS IS ALLOWED IN ALL CIRCUITS BUT THE NINTH; AND EVEN IN THE NINTH, THE RULE WAS THE SAME AS THE OTHER CIRCUITS UNTIL THE BEECHER CASE.

The courts in all other circuits have been contrary to the *Beecher* case, *supra*. A summary of the authorities is found in the case of *In re McComb Trailer Coach, Incorporated* (6th Cir., 1953), 200 F.2d 611, cert. denied, Sub. nom., 345 U.S. 958. This case categorically and expressly disagrees with the result in the *Beecher* case. It is demonstrated in the *McComb* case that not only is it the view of the United States Supreme Court but it is the view of the courts of appeal of all the circuits except the Ninth that interest on secured claims should be paid to the date of payment of the principal up to the amount of the security.

In addition to the cases cited and discussed above, and in addition to the cases used by appellant and appellee, the following cases are contrary to the rule in the *Beecher* case:

Worthtown Theatre Corporation v. Mickelson (8th Cir., 1955), 226 F.2d 212; *Eddy v. Prudence Bank Corp.* (2d Cir., 1947), 165 F.2d 157, 160, *cert. denied*, 333 U.S. 845; *Miles Company v. Tendel* (8th Cir., 1939), 107 F.2d 729, 732; *In re Kashmir* (2d Cir., 1938), 94 F.2d 652; *Board of Com'rs of Sweetwater County v. Bernardin* (10 Cir., 1934), 74 F.2d 809, 831; *Merchants Transfer & Storage Co. v. Rafferty* (2d Cir., 1931), 48 F.2d 540, 542; *Mtg. Co. v. Livingston* (8th Cir., 1930), 45 F.2d 28, 33; *People's Homestead Association v. Bartlette* (5th Cir., 1929), 33 F.2d 561; *Brown v. Leo* (2d Cir., 1929), 34 F.2d 127; *Phoenix Bldg. & Homestead Assocn. v. E. A. Carrere's Sons* (5th Cir., 1929), 33 F.2d 563; *In re International Raw Material Corporation* (2d Cir., 1927), 22 F.2d 920; *San Antonio Loan & Trust Co. v. Booth* (5th Cir., 1924), 2 F.2d 590; *In re Bowen* (E.D. Pa., 1942), 46 F. Supp. 631, 640; *In re Hagin* (La. D.C. 1927), 21 F.2d 434; *In re Stamps* (N.D. Georgia, 1924), 300 Fed. 162; *In re Hershberger* (M.D., Pa., 1913), 208 Fed. 94; *In re Stevens* (1909; D.C.), 173 Fed. 842; *In re Albert* (W.D.N.Y., 1908), 173 Fed. 691.

3. THE TEXTS AND ENCYCLOPEDIAS ANALYZE THE CASES AS REQUIRING THE PAYMENT OF POST-BANKRUPTCY INTEREST TO THE DATE OF PAYMENT.

In addition to the case authorities it is interesting to note that the texts and encyclopedias analyze the cases as requiring payment of post-bankruptcy interest to the date of payment of principal (3 Collier on Bankruptcy, p. 1840 (1941, 14th Ed.); 2 Remington on Bankruptcy, sec. 916, 2605; 6 Am. Jur., sec. 487, 1225; 8 C.J.S., secs. 242, 322, 422; 134 A.L.R. 846, 847-848). This rule has been well established for many years. In discussing the distribution of proceeds after a sale of property by a trustee, Remington on Bankruptcy, Vol. 6, sec. 2605 states:

"The rights of any particular lienholder against the sale proceeds depend, first of all, upon the amount due him under the terms of the instrument or agreement upon which he bases his claim to participate in the avails. He is entitled to interest if the obligation secured provides for its payment in accordance with the terms of such obligation, and it is computable to date of payment of the lien, not merely to filing of the bankruptcy petition, although such is not the case if the sale proceeds are insufficient to pay the full amount plus interest, in that event any interest which would remain by way of deficiency being collectible only to date of filing of the petition."

It is respectfully submitted that this statement presents the proper state of the law.

E. The Incorrect Rule of the Beecher Case is Being Given Full Application Against State Tax Liens.

The *Beecher* case has been applied by the District Courts and by the bankruptcy courts in this circuit to the secured claims of the State of California, including the secured claims which arise out of taxes owing by the bankrupt. Under the provisions of many of the tax statutes of the State of California, tax administrators may record in the Office of a County Recorder a certificate specifying the amount of taxes, interest and penalties due the State, and from the time of the filing of the certificate, a lien for all principal, interest and penalties is created upon all real property of the delinquent taxpayer in the county. The recorded lien has the same force and effect of a judgment lien (See, for example, Revenue & Taxation Code sections 6757 (Sales and Use Taxes); 7871 to 7872 (Motor Vehicle Fuel Tax); 26161 to 26162 (Bank and Corporation Taxes); 18881 to 18882 (Personal Income Taxes), and Unemployment Insurance Code section 1703 (Unemployment Insurance Taxes)).

We respectfully submit that the denial of interest on State tax liens for the period after the filing of the petition in bankruptcy to the date of payment is erroneous and is without legal support. The *Beecher* case has erroneously resulted in the State being denied interest for that period.

III.
CONCLUSION

We respectfully submit that in bankruptcy secured creditors should be paid interest to the date of payment if the security is adequate and the debt so provides. We further respectfully submit that *Beecher v. Leavenworth State Bank,* 192 F.2d 10 (9th Circuit, 1951) should be overruled as to this issue.

Dated: April 5, 1957.

Respectfully submitted,

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